SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

POST-HEARING COMMENTS OF CANADIAN NATIONAL RAILWAY CO.

In light of the importance of this proceeding for its future and the future of the entire industry, Canadian National Railway Co. ("CN") offers the following comments on the issues raised by participants in Ex Parte No. 582.

I. INTRODUCTION AND SUMMARY

While CN is mindful of the larger issues encompassed within the present proceeding, CN's most immediate concern is that it receive prompt review of the proposed BNSF/CN combination. This proceeding has demonstrated that a public interest decision based on sound logic and the facts developed in a fair evidentiary proceeding is entirely consistent with a proper resolution of the two basic issues on which most participants commented in Ex Parte No. 582.

The first issue is the "service difficulties and other disruptions associated with implementation" of prior transactions, principally the UP/SP merger and the division of Conrail between CSX and NS. Decision, STB Ex Parte No. 582, at 3 (STB served Jan. 24, 2000) ("January 24 Notice"). In one fashion or another, most participants sought to address the rail disruptions that followed these two transactions. The possibility that those carriers, in particular, would again have problems if they were to implement a merger was the single most often cited potential negative downstream effect. The Board should therefore consider post-transaction service disruptions the key issue raised in Ex Parte No. 582.

A majority of the participants in this proceeding said that the Board should address post-transaction service in the context of a fair and prompt evidentiary proceeding on the merits of a proposed control transaction.[1] These participants called for a proactive regulatory assessment of the effects that a proposed transaction may have on service. They ask the Board to consider a new factor in determining the public interest: reasonable assurance that a proposed transaction will not degrade the service of the proponents or other carriers. This suggestion is similar to the one that Mr. Tellier made in his opening statement, which noted that the Board can take the possibility of service failures into account without delay, through a policy announcement regarding its future determinations of the public interest. Indeed, the Board can make such a pronouncement in the course of the BNSF/CN proceeding itself, without prior regulatory action. Applicants will demonstrate in that proceeding that the BNSF/CN transaction is a relatively uncomplicated end-to-end combination of two carriers with similar information technology platforms and a management history of integrating combinations without serious service disruption.

The second major issue was competition, whether or not related to consolidations. Many participants asked for greater assurance that existing competitive options be maintained in a merger, and others expressed the opinion that there is a broader need to increase intramodal competition among railroads independently of the narrow effects of a particular consolidation. As to the former, because maintaining existing levels of intramodal competition has been a traditional matter for a control proceeding, the participants' interest in having the Board examine

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[1]Although the purpose of Ex Parte No. 582 was not to address the proposed combination of BNSF/CN, a significant majority of the participants – about 220 – requested that the Board consider the proposed transaction without delay and on its own merits.

these kind of competitive effects is consistent with CN's interest in having a fair and prompt control proceeding.

As for the latter, aside from the special consideration posed by the Conrail division, the Board has consistently ruled that it will not interfere in the marketplace to create new competition. Nothing prevents consideration of modification of that policy from being pursued in the BNSF/CN control proceeding; and an even more optimum forum would be a proceeding separate from our control proceeding. In particular, the Board could initiate a proceeding to determine whether applications resulting in a duopoly of only two transcontinental railroads in the United States or North America would pose special considerations warranting either heightened evidentiary requirements or amendments to the Board's rules to fit that special circumstance. Such a proceeding should not delay consideration of the BNSF/CN transaction, however. The BNSF/CN combination would not result in the creation of one of only two transcontinental railroads, and th creation of that duopoly structure was the focal point of the concern expressed at the hearing.

In sum, a majority of the participants expressed concerns that support, or are not inconsistent with, a fair and prompt proceeding on the BNSF/CN control application. Only a minority suggested that the Board decline to convene an evidentiary control proceeding for the BNSF/CN proposal, and that it instead impose a moratorium as a way to regulate "the timing of any proposed large railroad consolidations." January 24 Notice at 3.[2] Far more participants in the proceeding opposed a moratorium than supported it. More important, as we discuss below, a

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[2]By "moratorium," we mean any material direct or indirect delay in the normal processes for considering the merits of a proposed control transaction involving Class I carriers.

moratorium would not meet the predominant concern for post-transaction service that most participants voiced. It would instead occasion great and unnecessary economic dislocation. It would contravene the will of Congress, which has not authorized the Board to impose a merger moratorium under either the ICC Termination Act of 1995 ("ICCTA") or any other statute, and it would violate Congress's explicit directions requiring "the expeditious handling and resolution of all proceedings." 49 U.S.C. § 10101(15).

II. BECAUSE POST-TRANSACTION SERVICE DISRUPTIONS ARE MANAGEMENT ISSUES THAT ARE NOT ENDEMIC TO ALL CONSOLIDATIONS, THE BEST WAY TO ADDRESS THEM IS CASE-BY-CASE

The greatest concern expressed by participants in Ex Parte No. 582 was the poor quality of service that some railroads have been providing to the shipping public after their earlier consolidations, and the fear that shippers would suffer more of the same. As expected, almost all of the shippers who gave written or oral statements to the Board offered opinions about post-transaction service. Other federal agencies and all of the railroads also focused on post-transaction service. Financial analysts were predominantly concerned with each railroad's ability to grow and to earn sufficient returns for its shareholders, but the analysts also recognized that this ability was a direct function of each particular railroad's ability acceptably to meet the service requirements of its current and prospective customers. Most of the proponents of a moratorium also characterized their case as one aimed at improving service (misdirected though a moratorium may be towards that end, as we will discuss later). See, e.g., UPS Statement at 4; CSX Statement at 7-8.

Even before Ex Parte No. 582, most railroaders would have agreed that post-transaction service has become one of the most important issue facing the industry today. A merger moratorium, however, cannot really address this crucial service issue. That can best be done by directly focusing on post-transaction service in a control proceeding concerning a specific proposal.

A. Shippers and Most Others Were Principally Concerned With the Service That Followed Two Recent Consolidations

To say that most hearing participants were focused on post-transaction service levels does not state what their opinions were. A fair examination reveals a wide divergence in those opinions.

For example, shipper and other surveys that were presented to the Board expressed the highest satisfaction with the service that followed the CN/IC merger.[3] Confirming these survey results were comments and letters from over one hundred CN shippers who urged the Board to promptly consider the BNSF/CN transaction and expressed no dissatisfaction with the service they received following the CN/IC merger. Indeed, some of these told the Board that CN/IC had, for example, revitalized distressed businesses by opening up new markets. See Statement of Cagy Industries, at 1-2. Others came to Washington to tell the Board in person that rail service and shipper opportunities had improved following CN/IC. See TR. 207 (Emons Transportation Group), Tr. 234-235 (Quebec Railway Corporation), Tr. 361 (R.R. Donnelley) (Mar. 8, 2000). Still others, such as Associated Feed & Supply and the Farmers Cooperative, underscored that

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[3]See Results of December 1999 Mail Merger Survey, attached to NITL Statement; Valentine Statement; at 1.

they anticipated benefits from the BNSF/CN combination similar to the benefits they experienced from the CN/IC transaction. Tr. 208 (Mar. 9, 2000).

Of course, coming to Washington to testify in person entails travel and other inconveniences. It is therefore no surprise to find that many shippers did so in order to express dissatisfaction with disruptions that had followed the UP/SP merger and the division of Conrail by CSX and NS. Good rail service is vitally important to shippers, just like telephone or electric service; and, just like these other services, it is often taken for granted when it is provided in the dependable fashion that shippers deserve. When rail service has been disrupted, however, shippers can be expected to complain.[4]

It does not detract from the seriousness of the concerns of these dissatisfied shippers to examine exactly what it is that dissatisfies them. By far, most dissatisfied shippers discussed the extreme situation that developed after the UP/SP merger and/or the current difficulties that plague the integration of Conrail's operations by CSX and NS.[5] Nothing remotely comparable was said (or could be said) about service after the BN/SF or CN/IC mergers, however. Thus, there were many shippers, such as Shell Oil Company and Shell Chemical Company , who reported that:

> [i]n contrast to the service disasters we encountered in the consolidations [regarding SP and Conrail], we experienced smooth transitions with the integrations of both the Burlington Northern – Santa Fe and Canadian National – Illinois Central.

Shell Statement, at 11. The Department of the Army, whose interests are particularly high when it comes to service dependability, likewise noted that "both [BNSF and CN] have significant

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[4]The Board heard statements to that effect. See, e.g., Tr. 323-24 (Harsh) (March 9, 2000).

[5]See, e.g., GM Statement, at 4-5; Mazda Statement, at 2; Dow Chemical Statement, at 2.

experience with successfully executing past rail mergers without major service failures. . . . We believe there will be few service problems to shippers with this merger." Department of the Army Statement, at 5. Even some who expressed extreme dissatisfaction with others' service thanked BNSF for its successful efforts,[6] and admitted that the difficulties perceived with the BN/SF integration were relatively small. GM Statement, at 3. Similarly, of the hundreds of shippers who either submitted written statements or appeared live, only a handful expressed even the slightest dissatisfaction with the CN/IC merger.

The fact that only a handful of shippers experienced any service difficulties after either the CN/IC or BN/SF mergers – none of whom claimed the kind of serious disruptions that have been seen on UP, CSX, and NS – does not minimize the effects of the disruptions that occurred following the UP/SP merger and the Conrail division. It does, however, explain the divergence in opinions that the Board heard regarding the service that shippers have received after major transactions. The Board was reminded at the hearing that railroad companies are not uniform, and neither are their post-transaction services. See, e.g., Tr. 320 (Harsh) (Mar. 9, 2000).

B. The Board Should Directly Address the Post-Transaction Service Issue

Divergent shipper opinions regarding service underscore the need for a case-by-case approach to the post-transaction service issue. The level of service following a transaction is a matter of implementation that necessarily varies with the specifics of the transaction being

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[6]"UPS would like to acknowledge the efforts BNSF has taken to improve its service levels." UPS Statement, at 3. In fact, BNSF just set a new rail service record for UPS. Specifically, through February 24, 2000, BNSF moved 103,502 UPS loads, or more than 124 million packages, over 96 days without missing a delivery commitment. Tr. 93 (Krebs) Mar. 7, 2000).

implemented. There is no one-size-fits-all approach that will answer the divergent concerns expressed at the hearing.

Just like the other aspects of a control proceeding, which already call on the regulators to make predictive judgments on the facts of each case, the post-transaction service issue should also be addressed on the basis of the circumstances presented in the context of a promptly convened and fairly conducted control application process. The public interest standard is sufficiently broad to encompass the necessary examination. The Board can undertake an appropriate evaluation of possible post-transaction service difficulties during the course of the control proceedings; and it will have the ability to deal with those possibilities, as appropriate, through conditions, if the transaction is otherwise found to be consistent with the public interest. As noted, the Board could announce such a refinement of the public interest standard now, or it could adopt that refinement in the context of the BNSF/CN control proceeding.[7]

Mr. Tellier's opening statement suggested such a direct focus within the public interest examination, and that was also the thrust of the testimony from other government agencies such as the Department of Transportation and the California Public Utilities Commission. Similar suggestions for a greater focus on service within the Board's public interest framework were made by shippers such as AG Processing, Farmers Cooperative, and Fairmount Minerals; intermodal customers such as J.B. Hunt Transportation Services, Roadway Express, Emons Transportation Group, and Rail Van; and shipper associations such as the Western Coal Traffic League, National Grain and Feed Association, and the Edison Electric Institute.

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[7]The Board has in the past adopted other reasonable policy interpretations in the course of other adjudications. See, e.g., Boston & Me. Corp. – Abandonment Exemption, STB Docket No. AB-32 (Sub-No. 75X), 1996 STB Lexis 361 (STB served Dec. 31, 1996).

This approach would look case-by-case at any relevant history of post-transaction service performance by the applicants, as well as their resources available to carry out effectively the integration measures contemplated by their proposal, and to deal with any potential problems. For example, the BNSF/CN combination is the same kind of relatively uncomplicated end-to-end transactions as were both the BN/SF and CN/IC transactions, but neither the UP/SP nor CSX/NS transaction. Similarly, our control application will discuss the similarities of the information technology platforms of CN and BNSF, and the fact that we will not be displacing key operating personnel or eliminating important rail system redundancies. Neither was the case with the division of Conrail. This refinement of the public interest standard would also determine whether either partner is still suffering from past service difficulties, and whether the proposed combination is likely to do so in the future. Neither BNSF nor CN are suffering from service difficulties, and because the BNSF/CN transaction is entirely debt free, the combination will have the free cash flow that allows continued infrastructure investment, technological enhancements, and the ability to address capacity constraints, if any were to appear to develop.

On the other hand, this refinement of the public interest standard should not impose an absolute barrier to a proposed consolidation that included one applicant in financial difficulty, with deteriorating service, and another willing to come forward and resolve the problem. But, the general effect of its application would be to deter merger proposals by any two of the large Class I railroads unless and until their service performance and their financial circumstances were sufficient to warrant approval of their application on the merits. At the same time, the announcement of this kind of examination would allow the Board to discharge its statutory mandate to consider the BNSF/CN application on its merits.

This approach would fully address the concerns expressed by the other Class I railroads. They were concerned that the BNSF/CN transaction would force them to consider further merger proposals that would distract their managers from making improvements in customer service that are at this time their first priority.[8] While these concerns are not entirely plausible – it is not clear why these executives are not the masters of their own destiny, and nothing at the hearing or in the statements addressed that fundamental fallacy in their argument – they would likely be relieved from such distractions by the prospect of a threshold examination into whether substantial continuing service difficulties have been abated before a merger proposal could be initiated. That is because they would be presumptively unable to merge under this refinement of the public interest standard until after they have resolved these service difficulties. Moreover, a direct examination of financial circumstances would encourage financially responsible management of consolidations by insuring that the partners have efficient operations and are financially healthy before they consider and embark on further consolidations.[9]

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[8]Clearly, the activity of either opposing or seeking conditions for the BNSF/CN transaction in a control proceeding would not alone be so distracting.

[9]This approach would address the equity market's apparent concerns about the uncertainties of possible downstream mergers. Merrill Lynch, for example, issued a bulletin during the Board's proceeding to demonstrate that the drop in rail stocks "is reasonably comparable to the declines that occurred in some fuel sensitive trucking stocks." Merrill Lynch also suggested that the Board deny proposed mergers, ***unless***:

- "[a]s an indicator of efficiency, the operators each had annual operating ratios (expenses as a % of revenues) of 76% or less in the latest year prior to the application,"
- "[t]o assure financial flexibility, the debt ratio (debt as a % of debt plus equity) of the combined companies must be less than 45%," and
- "[a]s a test of service levels, each partner must now be achieving on-time

Two other useful suggestions have been made as to how the Board should directly regulate for sustained post-transaction service levels within the control application process, and the Board should adopt the basic principles of both. First, the California Public Utility Commission ("PUC") suggested that the Board institute a requirement that there be a service integration plan, as did the U.S. Department of Transportation. Just as the Board has in the past modified the requirements so as to now include a safety integration plan, it could also require this kind of service planning within the current public interest inquiry, without need for a rulemaking. That would serve the Board's stated need for a proper proactive resolution.

Second, as the California PUC also suggested, the Board could consider whether applicants are willing to guarantee pre-transaction service levels. Groups as diverse as the National Grain and Feed Association, Emons Transportation Group, and the American Short-Line and Regional Railroad Association agreed that the Board should examine, in its public interest inquiry, whether control applicants are offering such market-based financial incentives to provide sustained post-transaction service. Of course, everyone would prefer that there be good service in the first instance, and that no one would need to be made whole after-the-fact. See, e.g., Tr. 117-18 (Prillaman, Nat'l Lime Assoc.) (March 9, 2000). But, as the California PUC and the others have recognized, a guarantee to sustain pre-transaction service levels is a market-based approach that makes the railroad bear the kind of financial risk that best assures that post-transaction service will meet or exceed pre-transaction levels.

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performance that is at or near peak historic levels."

Although CN does not necessarily agree with the particulars of Merrill Lynch's proposal, we do agree that the Board should examine service capacity, debt levels, and operating efficiency of the partners to a control transaction. See CN Statement, at 18-24.

C. The Hearing Confirmed The Need For An Evidentiary Process Enriched by Inquiries that Reflect The Current State of the Industry

It is understandable why the Board may be "feeling the weight of the world" on its shoulders. Tr. 125 (Morgan) (March 7, 2000). The Board cannot realistically address the service issue outside the context of an evidentiary process provided by a control proceeding. Rather, the burden of finding appropriate solutions to this issue must be shouldered jointly by the many participants in that evidentiary process, within which proponents and opponents can illuminate facts for the Board's consideration. An evidentiary proceeding also channels the participants into an arena that facilitates cooperative settlement agreements (rather than public posturing) and focuses their efforts and the Board's attention on relevant areas of disagreement.

An evidentiary process has the further advantage of eliminating mere speculation from consideration and bringing into play the facts, including facts regarding claimed "downstream effects." For example, an evidentiary proceeding would allow railroads that claim to have consolidation plans to offer them for scrutiny. As of yet, there has been no opportunity for a detailed examination into either the circumstances under which the other Class I carriers are really considering any follow-on transactions, or whether they would have the ability to consummate them. Without the parties who know their own plans best coming forward and presenting them in an evidentiary proceeding, such plans are only a matter of speculation, as the Board recognized in its original Ex Parte No. 582 notice.

Indeed, it is readily apparent that some of what have been claimed as "downstream effects" are no such thing, and an evidentiary hearing would demonstrate the lack of any factual basis for those claims. One of the most curious of these is the argument that the threat of re-

regulation by the Board or Congress – especially in the form of so-called "competitive access" legislation – would be a deleterious downstream effect of the BNSF/CN transaction, if the Board were to approve it. However, there is no factual basis for the contention by UP's consultant that "[t]he likelihood of new regulatory controls has probably never been higher" (Scheffman Statement, at 11) at least as far as the Congress is concerned. The Board has received a number of letters from members of Congress since the announcement of BNSF/CN Transaction, and the record does not contain a single one that has referenced re-regulation, much less threatened it because of that Transaction.[10] A control proceeding would provide an opportunity for opposing railroads or others to show why a consolidation truly consistent with the public interest would not lead those with service problems to step up their service -- thereby *reducing*, not increasing, the pressure for such legislation.

In any event, it would be clear legal error to interpret the "public interest" standard to require that the Board assess whether a proposed transaction would likely cause Congress to re-regulate the industry in some fashion. Because the Board cannot substitute its judgment for that of the elected representatives in Congress, a particular legislative outcome cannot be contrary to the statutory public interest standard. It is Congress, after all, that determines whether such change is in the public interest.[11]

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[10]Senator Rockefeller acknowledged that he was advocating the same changes he had been advocating for years, with which Senator Dorgan was concurring. Tr. at 82 (Rockefeller) (March 7, 2000).

[11]Agencies may of course testify for or against proposed legislation, as did the ICC Commissioners before Congress enacted the ICCTA. The Board would thus be free to inform Congress that proposed legislation mandating, for example, access to bottlenecks would make it impossible for railroads to earn their cost of capital. But that is a far cry from an agency explicitly refusing to exercise its own existing powers so as to influence the legislative process

An evidentiary hearing has another advantage. It provides a forum where inconsistent propositions can be examined and resolved on the basis of facts. Take, for example, UPS, which is a transportation company larger than the entire railroad industry. UPS's statement (at 2-3) informed the Board that its business is dependent on rail service, and that its business is hampered by poor post-consolidation rail service provided by some carriers. If UPS has service-related concerns that relate to the proposed BNSF/CN transaction, it can raise its concerns within the BNSF/CN control proceeding. There, the evidentiary process will determine whether UPS's concerns have a basis in fact as far as the BNSF/CN transaction is concerned. UPS publicly acknowledges that its business is growing, and it has, in this proceeding, recognized BNSF's efforts in particular to provide it with superior and reliable service.

Similarly, the other Class I railroads have asserted here (contrary to their positions in their own control transactions) that BNSF and CN do not have to merge to acquire new efficiencies. According to these railroads (with whom CN disagrees on this point, as has the Board in its prior decisions) marketing alliances and information technology can produce essentially the same efficiencies and benefits as a merger. Also, in an implicit contradiction, they did not provide any reason why they could not themselves compete with the BNSF/CN combination using these same strategies. Instead, some of the Class I railroads have claimed that *they* will have to merge to capture competitive efficiencies.[12]

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towards the end of preventing particular legislative outcomes. Congress has never delegated such a function to the Board.

[12]See, e.g., Statement of Davidson, at 6; Statement of Norfolk Southern, at 9, Statement of CP, at 1.

UP's C.E.O. also claims that "we can compete against CN/BNSF, working in cooperation

They cannot have it both ways. Obviously, if the benefits of control were merely the equivalent of the benefits of other forms of alliance, these carriers could respond to the BNSF/CN Transaction through an alliance without the need for the "delays" and the "distractions" of a subsequent control proceeding. In any event, the key efficiencies of an end-to-end combination flow from the array of new single-line routings benefitting shippers – benefits for shippers that cannot be derived from an alliance. CN believes that the shipping community now needs these kinds of benefits, particularly with respect to North-South traffic flows; and this proposition can be and ought to be tested in the context of an evidentiary proceeding.

III. A MORATORIUM DOES NOT REMEDY POST-TRANSACTION SERVICE PROBLEMS, AND IS ALSO ECONOMICALLY HARMFUL AND CONTRARY TO LAW

The direct approach of proactively examining post-transaction service issues is the best way to minimize the possibility of any future merger-related service disruptions. A moratorium will not fix past service failures; it will instead *reduce* competitive pressure to improve service. As for future service failures, a moratorium would certainly forestall any failures associated with any transaction that was delayed by the moratorium, but that would only be delay, not prevention. Meanwhile, for the duration of the moratorium, the substantial benefits of any "good" transaction would be lost, including any service benefits. Moreover, service quality might decline even more within the existing structure. Investors might well decided that the industry was at a dead-end or under a new anti-market regulatory regime, and as economists who addressed a moratorium predicted, begin to withdraw the capital that would otherwise be available for service

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with CP and other carriers." Statement of Davidson, at 1. Neither Mr. Davidson nor UP has explained the contradiction between UP's present ability to compete with a combined BNSF/CN and it claimed need to merge before UP could compete.

improvements. See, e.g., Tr. 268-71, 280-81, 297 (Hamada); Tr. 265, 291-92 (Hahn); Tr. 304 (Candell) (Mar. 9, 2000). Notably, UP's consultants provided no analysis to suggest the contrary.

In addition to its unwise policy ramifications, a moratorium would also be improper from a legal perspective. First, because a moratorium would cause great economic harm without addressing the service issues, it would be an arbitrary and capricious option. Second, and in any event, a moratorium would be contrary to the Board's statutory authority.

A. A Moratorium Would Be Arbitrary and Capricious Because It Would Not Meet the Legitimate Concerns of Those Who Advocated That the Board Require the Railroads to "Take a Breather."

Taken as an aggregate, the participants most strongly opposed to further consolidations argued most of the following points: (1) shippers have been hurt by the severe service disruptions following two recent consolidations; (2) the central task of the industry must be to restore service and shipper confidence in that service, which are essential both for shippers and for the financial health of the industry; (3) accomplishing that task will take an indeterminate period of time, possibly measured in years; (4) the BNSF/CN proposal will trigger at some unspecified time a round of consolidation proposals by other major railroads, ultimately including proposals for only two transcontinental railroads in the United States; (5) such a round of consolidation proposals will distract the industry from the central task of improving service, and will increase calls for congressional re-regulation; (6) a moratorium on the BNSF/CN proposal and any further consolidation proposals would avoid the distractions and eliminate the risk of congressional re-regulation, and the Board should impose such a moratorium; (7) further, the Board's rules and policies governing consolidations are outmoded and the Board should revise them.

Faced with these arguments, the Board must decide how best to facilitate the restoration of service and, at the same time, (a) remain within its authority, (b) faithfully discharge the functions mandated by Congress, and (c) avoid arbitrarily or erroneously denying to shippers the benefits of the BNSF/CN consolidation or any other consolidations that would prove, in fact, to be in the public interest. The Board must deal with these issues during a time of rapidly changing patterns of trade, investment, production and distribution that are making unprecedented demands upon the rail system for the kinds of benefits brought by expanded networks and end-to-end consolidations.

Difficult as the task is, the Board can do it without resort to arbitrary methods. The key lies in a precise assessment of the issues. No one seriously argued that the activity of merely opposing the BNSF/CN transaction in a control proceeding before the Board, or of seeking conditions in such a proceeding, would significantly distract the managements of NS and CSX from improving their service. (UP reports that it is over its service difficulties, and the Board has concurred, also determining that UP's service disruptions were essentially caused by events other than its merger.) If anyone believed that CN and BNSF, the two most efficient railroads in North America, would suffer a post-transaction decline in service, they can pursue that claim before the Board in the control proceeding. As we have seen, whether their implementation of their transaction, if approved, would cause a service deterioration is properly an issue for such a proceeding, building on a service integration plan. The issue then becomes: would approval of the BNSF/CN proposal trigger a general round of consolidations, which, so the argument goes, would surely turn the attention of managements other than BNSF and CN away from service.

Again, we have already seen that the Board can adopt a refinement of its public interest standard that would minimize that risk.

A moratorium, by contrast, would not be a reasonable response to the concerns pressed upon the Board during the hearing. It is not a forthright, directed way of responding to the concerns voiced at the hearing. Instead, it is an overly broad response that would itself impose high costs, rendering it an arbitrary and capricious option.

Those participants suggesting a moratorium advanced several propositions in support of their position, but a quick review of those propositions demonstrates that a moratorium is not required or well-suited to achieve the ends they seek. Indeed, in many cases, a moratorium could not achieve those ends or would in fact preclude their achievement. That may account for the fact that there was no consensus among moratorium proponents either on what would be a reasonable time period or on what factors should be used by the Board to determine the appropriate end point for a moratorium.

- A moratorium would not remedy any remaining service problems from past transactions. Indeed, unless those carriers chose to merge again, a moratorium would only have the effect of relieving them of the need to respond to competitive pressures that might be imposed by other transactions, thus weakening the incentives they have to improve their service.
- A moratorium on all mergers cannot be justified by "merger fatigue" that was suffered by the customers of some railroads but not others. While many shipper participants at the hearing were justifiably aggrieved by the service problems that they attributed to prior transactions, a moratorium would throw the baby out with

the bathwater. Applying a general rule in response to very particular problems when a well-targeted response is readily available would be highly arbitrary. This would especially be so when no one has even attempted to make the case that any economic benefit could be derived from a moratorium. To the contrary, all of the economists who have analyzed the effect of such a moratorium in statements submitted in this proceeding opposed and described the harmful economic consequences from such a moratorium.[13]

For example, a common refrain from dissatisfied shippers was that the industry should "take a rest" following the post-transaction service difficulties of those railroads that have experienced them after recent major mergers. In his written testimony on behalf of CP, Robert J. Ritchie similarly stated (at 3-4) that customer confidence would have to be restored before any carrier should move forward with another transaction. Of course, BNSF has now "rested" for almost five years following the generally smooth BN/SF implementation, and CN/IC has not had any service difficulties from which a rest would be needed. And there was virtually no testimony regarding a lack of confidence in CN's or BNSF's current service, such as has arisen following the troubles on CSX, NS and UP. On the other hand, a forced "rest" for the rail industry would come while the rest of the economic world continues with its relentless change. The resulting imbalance would be particularly harmful to those who rely on rail. As an example, officials

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[13]See, e.g., Tr. 263, 265, 291-92 (Hahn); 268-71, 280-81, 297 (Hamada); 307 (Harsh); 311-15, 316-17 (Vellturo); 303-04 (Candell) (Mar. 9, 2000).

from Mississippi strongly demonstrated for the Board that a moratorium that would prevent or delay the BNSF/CN combinations would impose extreme economic dislocation on Americans who are struggling to emerge within the rapidly globalizing economy. See, e.g., Mississippi Econ. Council Statement, at 2; see also Tr. 307 (Harsh); Tr. 311-15 (Vellturo) (Mar. 9, 2000).

- A moratorium is also not needed to preclude a transaction by a carrier with customers that are suffering from service problems. As we explained above, the answer to those problems is not to preclude the opportunity for carriers with good service records to improve their service, but to raise the merger bar for those carriers with problematic service and strained resources at least until their customers are receiving acceptable service.
- A moratorium cannot be justified by low stock prices or the desire for higher stock prices. The evidence is that the prospect of future transactions has had little or no impact on stock prices. Participant Valentine, of Morgan Stanley, indicated, for example, that a moratorium would not lead to a sustained equity value/share price increase, and that any increase, if there were one, would tend to be transitory, because investors would come to realize that the industry, at the choice of the regulator, was at a developmental deadened. Other Wall Street experts and economists have predicted a flight of capital if a moratorium were imposed (which could occasion a further decline in stock prices). See, e.g., Tr. 254-57 (Kaplan), Tr. 263-64 & 273-74 (Larsen) (Mar. 7, 2000); Tr. 279-82 (Hamada) (Mar. 9, 2000).

- A moratorium would be detrimental to the financial condition of the rail industry and is not needed to protect the financial state of the industry. Participants with perspectives as diverse as the Department of Transportation and the three financial analysts who appeared before the Board agreed that there is no current industry-wide financial crisis that renders it unstable. See, e.g., Tr. 43 (Sect'y Slater, U.S. Department of Transportation), Tr. 249 (Valentine), Tr. 266-70 (Larsen), Tr. 272 (Kaplan) (Mar. 3, 2000). Expert opinion was uniform that a moratorium, however, would itself be financially destabilizing. See, e.g., Tr. 263-72 (Hamada) (Mar.9, 2000).
- A moratorium will not bring "stability" to the industry. A moratorium will merely postpone the normal functioning of the market as it seeks a balance among the interests of railroads, employees, customers and providers of capital.
- A moratorium will not preclude, but will instead increase, the pressure for re-regulation. It is hard to imagine a more draconian form of re-regulation than a moratorium on the normal functioning of the markets as they seek the optimum form of production in the railroad industry. The moratorium itself could be the catalyst for further re-regulation. Since the market would no longer be able to discipline weak performers by threatening them with competition or takeover of their companies if they do not perform, those who seek improvement in carrier performance may conclude that re-regulation to change price and service has become the only outlet. As Norfolk Southern's Chief Executive Officer has himself proclaimed, in a less self-interested forum, "[a]t Norfolk Southern, we

resist *any* attempt at re-regulation, whether it comes in the form of mandated rates, forced access, *or some other guise*." David R. Goode, "Regulation: It's Not the Fix for Short Term Service Issues," Paces, Sept./Oct. 1999, at 1 (emphasis supplied).

- A moratorium is not needed to preclude the scenario of only two "North American Railroads." No proposal before the Board today requires that there be a two-railroad "end game," and, of course, none can occur without the Board's approval. Therefore, the Board is able to explore the desirability of this "end game" though its policy-making mechanisms without imposing a moratorium on the review of other, more limited transactions. Should there be a question whether a particular, more limited transaction – such as the BNSF/CN combination -- will inexorably lead to that end, then the place to explore the public interest in that matter is on the record of that case, where the parties who believe in inexorability can come forward with facts, so that testimony under oath, rather than vague assertions, will determine the results.

In the end, a moratorium would serve only one real purpose. It would satisfy the aims of those railroads who seek protection from competition. These railroads argue that this is consistent with the public interest because more competition would require them to make a "strategic response" that would injure their shippers. And, obviously, many of their shippers believe that they would be foolhardy enough to attempt an action that could be predicted to harm shippers. But this is not a legitimate reason for a moratorium. The public interest requires whatever increases in competition that the market will support.

If there is a threat of an imprudent response to that competition, then the answer is to stop the imprudent response, not the beneficial increase in competition. Stopping the good to prevent an evil that can otherwise be prevented cannot possibly be consistent with the public interest, but rather would be arbitrary and capricious.

B. A Moratorium Would Be Contrary To Law

In addition to the harm occasioned by such an arbitrary device, a moratorium would also contravene the Board's statutory mandate. Fear of the future is not a transportation policy consistent with Congress's direction. First, a moratorium's protection of competitors is inconsistent with the Rail Transportation Policy. Second, its delay would violate both that policy and the ICCTA scheme.

1. A Moratorium Would Be Anti-Competitive, in Contravention of the Rail Transportation Policy

A moratorium on consolidations would be an unlawful cartel if imposed through private agreement. The anti-competitive consequences are obvious. The scale, scope and structure of firms are important determinants of industry behavior and performance; nowhere can that be more true than in the case of a network industry, the very definition of which is that the value to one customer depends in part on the number of other customers. An agreement not to compete for advantage through changes in scale, scope, and structure would therefore be a fundamentally anticompetitive interference with the natural workings of the market.

There can be no real question, for example, that delay in the BNSF/CN transaction will reduce competition. This is clearly the view of the protectionist carriers. That is why they say that the BNSF/CN combination would require the "strategic response" that many of their

shippers seem to fear. No one initiates a strategic response to a competitor's action unless that action poses a substantial competitive threat. Vellturo Statement, at 9-12. If the protectionist carriers thought the BNSF/CN combination would fail, they would not be here. Id. Instead, they would be taking steps to support the transaction in one way or another, in the hope that it would diminish competition and increase their prospects. Their support for a moratorium indicates that a moratorium would be anti-competitive, and that their self-serving views should be rejected for that reason alone.

The anti-competitive nature of a moratorium is not cured by the notion that a moratorium is needed to maintain some sort of "competitive balance." This argument mistakenly suggests that, because railroads operate within the larger framework of a common network, one part of that network cannot become more efficient without threatening the "competitive balance" of the entire industry.[14] This notion is facially anti-competitive, however, and cannot be squared with the Rail Transportation Policy's mandate that the Board ensure effective competition between rail carriers and with other modes. By definition, the act of balancing competition within the rail industry diminishes the ability of individual railroads to compete vigorously with other railroads. Worse, it freezes the level of rail efficiency to a narrow band around the least common denominator. In the meantime, the other modes of transportation are free to develop and increase their market share. And, overseas products that are not as dependent on rail transportation are also able to capture market share from the North American producers who are dependent.

If this were a state regulatory proceeding, a moratorium that precluded a private party from taking action that would enhance competition could constitute a violation of the federal

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[14]Tr. 159 (Ritchie); Tr. 176 (Snow); Tr. 193-95 (Goode) (March 7, 2000),

antitrust laws. See Community Communications Co. v. City of Boulder, 455 U.S. 40 (1982). Although the antitrust laws do not apply to federal agency action, and although the Board has responsibilities in addition to encouraging competition, it is obliged to consider the guidance provided by the antitrust laws in its regulatory actions concerning control applications. E.g., Union Pac. Corp. -- Control and Merger -- Southern Pac. Rail Corp., Finance Docket No. 32760, Decision No. 44, slip op. at 102 (STB served Aug. 6, 1996). A moratorium that precluded pro-competitive action would be anti-competitive in effect and contrary to the agency's express statutory direction under the Rail Transportation Policy "to ensure effective competition." 49 U.S.C. § 10101(5).

2. A Moratorium Would Also Violate the ICCTA

Finally, no moratorium proponent has identified any authority at all for the Board to decline to exercise its duty to consider consolidation proposals according to the strict statutory timetable set forth in the ICCTA. Rather, those few moratorium proponents who did address the issue recognized its seriousness. See Tr. 87 (Sen. Dorgan) (Mar. 7, 2000); Tr. 22-23 (Rep. Quinn) (Mar. 8, 2000).

There is a good reason why the proponents of a moratorium, with all their lawyers, have not cited any authority for a moratorium. There is none. Congress provided no discretion for the Board either to shut its doors and prevent the filing of rail control applications or to decline review or disposition of such an application, once filed.

An agency vested with authority to decide applications on their merits must decide them on their merits. While the substantive standards governing such decisions may be as broad as the "public interest," the agency does not have discretion to decline to exercise its deciding function

in this manner. Moreover, to decline here would unreasonably withhold agency action, in violation of the Administrative Procedure Act. 5 U.S.C. § 706(1). See Forest Guardians v. Babbitt, 174 F.3d 1178, 1190 (10th Cir. 1999).

In the ICCTA, moreover, Congress exhibited a keen concern for the time within which applications were to be decided, and a moratorium would directly contravene the Congressional scheme for control transaction review. First, the need for "expeditious handling and resolution of all proceedings required or permitted to be brought under this part" is explicit in the Rail Transportation Policy. 49 U.S.C. § 10101(15); see also id. § 10101(2). Second, the ICCTA also precludes categorical prohibitions of consolidations for some open-ended period of time. Instead, Congress limited the Board's power to defer consummation of consolidation proposals – the essence of a moratorium – by tightening the mandatory statutory deadlines within which the Board must make the required public interest determination.

The ICCTA statutory scheme is unique to railroads and the STB. Unlike the statutes governing agency review of consolidations within other industries, it mandates tight deadlines for the Board to review and issue a final decision on a control application. Unless the Board rejects an application as incomplete, the Board "*shall*" publish notice of its filing within 30 days. 49 U.S.C. § 11325(a).[15] If the transaction involves Class I carriers, the Board "*must*" conclude evidentiary proceedings within one year from the publication of such notice. 49 U.S.C. § 11325(b)(3). The Board also "*must*" issue a final decision within 90 days of the conclusion of evidentiary proceedings. 49 U.S.C. § 11325(b)(3). Overall, therefore, the Board has up to 16

[15]In practice, the STB "accepts" the application when it publishes such notice of filing.

months to initiate, consider, and conclude a control proceeding.[16] It has no authority to create any greater delay.

Case law holds that other deadlines for action in the agency's statute are mandatory and cannot be avoided through the construction of procedural impediments or otherwise.[17] We are also aware of no authority sustaining moratoria imposed by other agencies involving statutory regulatory schemes that imposed deadlines on agency action comparable to those in the ICCTA, and, as noted, none of the proponents of a moratorium have brought such a case to the Board's attention.

The Board's mandate under § 11325 is not relaxed by § 11324(a), which provides that the Board "may begin a proceeding to approve and authorize a transaction referred to in § 11323 of this title on application of the person seeking that authority." The seemingly permissive "may" reflects nothing more than the fact that, as noted under § 11325, the Board need not begin a proceeding if it rejects an application for being incomplete on its face. Union Pac. Corp. – Control – Missouri Pac. Corp., Finance Docket 30,000 (Sub-No. 1), 45 Fed. Reg. 63,164, at 63,165 (Sept. 23, 1980) ("An adversary proceeding will not begin until the application is formally accepted").[18] Thus, notwithstanding § 11324(a), prior decisions recognize that the

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[16]The ICCTA reduced this period from 31 months under prior law.

[17]See, e.g., Kentucky Utils. Co. v. ICC, 721 F.2d 537, 545 (6th Cir. 1983); Wheeling-Pittsburgh Steel Corp. v. ICC, 723 F.2d 346, 357 (3d Cir. 1983); Utah Power & Light Co. v. ICC, 747 F.2d 721,725 (D.C. Cir. 1984). These cases held that the ICC had no authority or discretion to extend the time for acting beyond a 30-day period prescribed for ICC review of certain regulatory action.

[18]In this connection, the Board's notice of the filing of a notice of intention to file an application must identify, *inter alia*, "any additional information which must be filed with the application in order for the application to be considered complete." § 1180.4(b)(v). Here, for

agency must act "consistent with the strict deadlines that Congress has mandated for handling mergers" in what is now § 11325. Santa Fe Pac. Corp. – Control -- Southern Pac. Transp. Co., Decision No. 32, 1987 WL 99095 (ICC decided July 30, 1987).

It has been suggested (at least in the press) that the Board may have authority to exceed the deadline Congress imposed in § 11325 by invoking its power under § 10502 to grant exemption from regulation. However, such exemption authority cannot be invoked to *impose* or *enlarge* regulation. AAR v. STB, 161 F.3d 58, 63 (D.C. Cir. 1998) ("discretionary power to deregulate 'does not authorize the utilization of . . . deregulatory powers as a means to achieve a new regulatory format'" (quoting Brae Corp. v. United States, 740 F.2d 1023, 1059 (D.C. Cir. 1984), cert. denied, 471 U.S. 1069 (1985)). Yet that is what a moratorium or extension of any of the deadlines of § 11325(b) would do.

It may also be thought that the Board should adopt a moratorium because it would be in the "public interest." However, the "public interest" test governing the Board's actions is not part of a general authorization for the Board to take any action it wishes concerning the subject of railroad consolidation, so long as it is in the "public interest" in the abstract. The Board has no such broad regulatory authority. Rather, the "public interest" test under the ICCTA has a very specific and limited *procedural* context, governing only the Board's approval of a transaction in a proceeding already begun upon application by a person seeking control authority. 49 U.S.C. § 11324(c). There is no "public interest" or other authority for the Board to adopt rules or

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example, the STB did so in Decision No. 1A, served Dec. 28, 1999. Thus, the Board's own rules do not provide any further authority for the Board to delineate what will make an application acceptable. Applicants will conform fully to Decision 1A, and will, in addition, provide additional information and undertakings that address shipper concerns, for example, service guarantees, service integration plan, etc.

regulations or to preclude such an application from being filed, on the ground that the filing of the application or the proceeding itself would be contrary to the public interest.[19]

Merger moratorium proposals that have been made elsewhere concerning other industries have thus arisen in contexts that have no bearing on the ICCTA scheme. Nonetheless, they do serve to underscore the extraordinary nature of the proposals for an agency-imposed moratorium made here. For example, in a speech at FERC in January 1998, Assistant Attorney General Joel Klein, in charge of the of the Department of Justice's Antitrust Division, stated that he had asked the House Judiciary Committee in 1997 to consider the possibility of a moratorium on mergers in the unique circumstances of the electric power industry, which was on the threshold of moving from a system of legal monopolies to open competition. Assistant Attorney General Joel Klein, Address at the Federal Energy Regulatory Commission Distinguished Speaker Series (Jan. 21, 1998). However, he was addressing a proposed *legislative* moratorium for consideration by Congress. Notably, Mr. Klein, did not include such a moratorium proposal among the actions that he suggested that FERC itself could or should take. Id. (Nor did the Department of Justice advocate or support adoption of a moratorium by the Board here.) It is noteworthy that, nearly three years later, Congress has not enacted any such moratorium.[20]

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[19]The Board does have emergency powers with respect to certain rail operations, which are inapplicable here, but even that authority may only be exercised for 30 days, and may be extended only for up to 270 days total. 49 U.S.C. § 11123.

[20]To the contrary, Congress has shown a disposition to reject, not embrace, similar proposals for a moratorium in a particular industry, such as a proposal by Senator Wellstone for an 18-month moratorium on mergers in the agribusiness sector. See 145 Cong. Rec. S14654-704 (Nov. 17, 1999).

Proposals were also made in 1998 by opponents of electric utility mergers that FERC adopt a rule imposing a moratorium on such mergers (Joint Petition of American Public Power Ass'n. For Moratorium on Certain Public Utility Mergers, RM98-6, filed April 6, 1998), and defer its consideration of the biggest electric merger in history, pending adoption of such a rule. Motion to Intervene and Protest of American Public Power Association, in American Elec. Power Co., No. EC98-40-000 (June 30, 1998). FERC has done neither.

As Rep. Quinn noted on March 8, if the Board feels a need to be freed from the statutory deadlines so that it could consider or impose a moratorium, "it should so advise the Congress." Tr. 21. If it is a good idea, Congress will presumably act on it. We note, however, that in the more than two months since the BNSF/CN combination was announced there has been no such legislative initiative.

Finally, we note that one particularly developed moratorium proposal, submitted by Edison Mission Energy ("Edison"), attempts to sidestep the illegality of a moratorium through the inclusion of a provision for waiver based on a vague standard. This attempt fails, and to the extent Edison's submission could be construed as a petition for a rulemaking, it should be denied. One of the vices of a moratorium provision is its interference with the normal operations of the capital markets. No major control transaction would likely be agreed to if it were contingent on the vagaries of a waiver process, especially given that the potential parties would likely not want their strategic actions made public prematurely, in connection with a waiver request, without knowing whether they would be able to seek approval for several more years.[21]

[21] The Edison waiver proposal is particularly deficient if it contemplates that the parties would have to file a proposed application to support a waiver request. Few parties would go through the time, trouble, and expense of preparing an application without knowing if a waiver

In any event, the rule proposed by Edison (as well as most of the other moratorium proposals) raises grave problems of unreasonable retroactive application. That proposal, if adopted, would govern when, after January 1, 2000, a notice of intent to file an application might be filed; however, the notice of intent for the BNSF/CN Combination was filed on December 20, 1999, and was deemed properly filed by the Board's publication of the required notice on December 28, 1999, in Decision No. 1A, in which, in accordance with its rules, the Board specified "any additional information" for the application to be accepted. 49 C.F.R. § 1180.4(b)(2)(v). It would be totally unreasonable, after that acceptance, for the Board, by rule or otherwise, to now impose significant new standards on the sufficiency of the notice of intention or the acceptability of the application.[22]

The relevant time for judging the fairness, reasonableness, or legitimacy of a new rule or policy is not whether it is adopted before an application or notice of intention is filed, but whether it is adopted before the parties enter into a transaction with reasonable reliance regarding the existing legal framework. BNSF and CN reached their agreement in December 1999, before

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would be forthcoming. A rule that would block a control transaction because of the cost, burdens, and uncertainties of the application process, rather than the merits, would be contrary to the ICCTA's basic principle of "fair and expeditious regulatory decisions" embodied in the Rail Transportation Policy. 49 U.S.C. § 10101(2).

[22]The Edison proposal contains another flaw that demonstrates the difficulties of drafting such a provision. It would run for three years from the "implementation" of the last prior approved control transaction. However, as the Board has recognized in the New York Dock context, while such transactions may be substantially implemented within a several-year period, they may not be fully implemented until many years later. Moreover, such a standard could leave it within the power of the parties to the last preceding transaction (here, CSX and NS) to control the duration of the moratorium (and hence of the deferral of new competition) by deferring the completion of implementation.

there was even a moratorium proposal on the table. Such a change of rules now would be unfairly retroactive in its application to BNSF/CN. This kind of retroactive alteration would also undercut investors' confidence in the rail industry, and thus diminish the industry's access to capital. See, e.g., Tr. 253 (Valentine); Tr. 254-57 (Kaplan); Tr. 263-64 & 273-74 (Larsen) (Mar. 7, 2000); Tr. 279-82 (Hamada) (Mar. 9, 2000).

IV. IF THE BOARD WERE TO EXPLORE ISSUES SUCH AS POTENTIAL FUTURE PROPOSALS FOR CONSOLIDATIONS RESULTING IN ONLY TWO U.S. TRANSCONTINENTAL RAILROADS AND THEIR IMPACT ON RE-REGULATION, IT SHOULD DO SO IN A BROAD POLICYMAKING INQUIRY

Many comments addressed issues that are quite separate from the merits of the proposed BNSF/CN transaction, that need not be resolved before that proceeding goes forward, and that the Board need not resolve at this time. One issue concerns the question raised by the Board about what should be done if, as some have speculated, the structure of the industry might "ultimately result[] in the formation of two North American railroad systems." January 24 Notice, at 2. The other issue concerns whether there might be "changes . . . in the way in which the industry is regulated." Id.

Despite the volume of responses, relatively little in the comments usefully addressed the paradigm of only two U.S. transcontinental railroads. Arguments that such a duopoly is inevitable or should not be allowed to happen do not productively address how such a duopoly would be different and what should be done because of those differences if it became a concrete possibility. It is not enough to urge "Just Say No." At this time, the record on those key issues is simply inadequate to permit the Board to fashion sound policy.

Indeed, there has not even been a proper demonstration regarding the claim of inevitability. There certainly was no consensus on that point at the hearing. As noted, a party in the control proceeding could expose to the evidentiary process its contention that some U.S. transcontinental combination is inevitable. But a more optimum forum for exploring this structure would be a further, more-focused public hearing, building on the diffuse comments here, and perhaps containing an evidentiary component. In the course of such contemplation of that market structure, the Board might choose to revisit some aspects of the existing regulatory framework bearing on competition and other issues.

The Board also received little help on the subject of possible change in the existing regulatory framework. Instead, it received familiar calls for reversal from parties unhappy with the way various issues hav been resolved in prior rulings of the ICC, the Board, the courts, and Congress. Requests that those rulings be reversed, however, have no particular relationship to structural and regulatory issues that may posed by having only two U.S. transcontinental railroads – nor, we hasten to add, to the BNSF/CN transaction. Some parties might eventually argue that those rulings have a different bearing in the context of a U.S. transcontinental railroad duopoly, but they have not been so focused. Again, a further proceeding directed to that paradigm could provide a more productive framework for giving further consideration to such claims.

Finally, a moratorium would not resolve either of these two sets of issues. It would merely postpone the day when they need to be addressed. But these issues concerning the possibility of only two U.S. transcontinental railroads can effectively and usefully be addressed

separately even if the BNSF/CN proceeding goes forward, because they relate to the results that might flow from one of the next transactions, not that one.